Rates Spark: US payroll revisions could challenge recovered sentiment

Markets are moving cautiously in anticipation of today's US payroll revisions. Estimates vary, but chances are we'll see a significant downward revision of earlier payroll numbers. With risk sentiment still fragile, the balance of risk seems to be tilted towards lower yields and steeper curves

US payroll numbers were probably significantly lower than previous estimates

After a clear return of risk appetite over the past week, markets seemed to move a bit more cautiously yesterday. Bonds were in demand with the 10y US Treasury yield down a few basis points towards 3.8% and 10y Bund yields closing in on 2.2%. A downside surprise of the Philly Fed index helped yields lower, but the move was broader than just stemming from this second-tier data point.

If anything, markets are holding their breath for today's revision of US employment statistics. Tax data will be used to review the accuracy of the published payroll numbers from April 2023 to March 2024. The job creation number could be revised downward by as much as 800,000 jobs, according to some estimates, which would mean the labour market may not be as strong as portrayed earlier.

Risk sentiment recovered from turmoil but remains fragile

With inflation slowly converging to target, financial markets are increasingly sensitive to recession concerns, and thus a downward revision of job numbers could bring about another risk-off episode. Remember that previous payroll disappointment helped trigger the turmoil just a few weeks ago.

If the payrolls revision does not bring about a sharp negative surprise, the upside to bond yields may be limited, and thus the risk seems asymmetric. Risk sentiment has recovered already, so there is little gain from a further improvement there. A stronger number would also not change much to the Federal Reserve's easing trajectory as the latest job data is already hinting at a cooling labour market.

We continue to maintain a bias for duration and steeper curves, also as we go into today's releases. The broader economic backdrop is one of slowing economic growth and the start of a cutting cycle. A weaker jobs number could accelerate the front end down due to recession risk concerns, whilst the back end should also go somewhat lower as risk sentiment weakens again. Bund yields are likely to follow as little data from the eurozone is there to drive the direction.

Today's data and market views

US payroll revisions will take the global spotlight, with the FOMC minutes from July's meeting later.

In terms of issuance, Germany will auction a 10y Bund for €4.5bn. We also have a syndication from KfW for a new 5y Green bond for an estimated €2-3bn. From the UK, we have a 3y Gilt for £3.75bn, and from the US a new 20y Bond totalling $16bn.

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